Economic Outlook

Irving Trust

Irving Trust Company
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Economic Research &
Planning Division

November 1985

Real economic growth appears to be moving into a more normal range after an extended slowdown. Growth in real GNP went from 0.3% at an annualized rate in the first quarter to 1.9% in the second quarter and 3.3% in the third quarter. It is likely that growth in the next several quarters will top the third quarter's rate. The pieces are in place for resumption of more satisfactory economic growth: a monetary policy that turned increasingly accommodative during the past year, significant depreciation of the dollar, and visible progress toward correcting inventory imbalances that developed during the slowdown. Nevertheless, there is much turmoil below the surface; signs of hesitancy abound.

To allay concerns that the improvement in real growth might not be sustained, Mr. Volcker seemed to go out of his way recently to indicate that the Fed has essentially become resigned to accepting above-target money growth this year. His statement gave further momentum to the rally in the stock market by intimating that if the economic turnaround fizzles out, it will not be because the Fed chased an errant monetary indicator. From our point of view, these developments reinforce the prospect that the economy will grow at more respectable rates in the quarters ahead. Real GNP is expected to increase 2.4% from the fourth quarter of 1984 to the fourth quarter of 1985 and 3.5% from the fourth quarter of this year to the fourth quarter of next year.

The monthly economic indicators continue to give erratic signals. For example, nonfarm payroll employment rose by a scant 138,000 in September, only to be followed by a robust gain of 414,000 in October. With so much attention on layoffs and the slowdown, it is sometimes forgotten that payrolls expanded by almost 3 million workers during the past 12 months. Retail sales have mirrored the roller coaster in auto sales, as total retail sales rose 2.1% in September and then plunged by a record 3.3% in October. If auto sales remain near current lackluster levels, it is likely that another round of incentive financing will be introduced early next year to boost sales (as assumed in our forecast). Nonauto retail sales showed month-to-month increases of 0.2% in September and 0.5% in October--basically mediocre performance. Even if nonauto retail sales continue to register only modest gains, many retailers will likely benefit from higher profit margins in the fourth quarter of this year compared to last year's results. Because of tight inventory control throughout 1985, the current situation is less promotional than a year ago, when inventories had become excessively high relative to sales.

In past business cycles, a set pattern of developments has usually been evident as the recovery matures. Capacity constraints develop; commodity prices rise as delivery times stretch out; and a recession ensues as monetary policy becomes increasingly restrictive to curb inflationary excesses. During the year prior to all recessions that occurred in the period 1960-1980, capacity utilization in manufacturing hit at least 85.6%. In September, capacity utilization was only 80.0%, while the peak rate in the current recovery was 81.8%. As a result, particularly in view of the willingness of foreign producers to serve U.S. markets, it appears that this recovery has ample room to continue.

Bernard Schoenfeld

Irving Trust

Economic Forecast

Percent Changes at Annual Rates

	Actual				Forecast				Actual	Forecast	
				1985				1986	1983-	1984-	1985-
	I	II	III	IV	I	II	III	IV	1984	1985	1986
Gross National Product	5.6	4.5	6.7	7.8	7.9	8.1	7.6	7.4	10.8	6.3	7.5
Real GNP	0.3	1.9	3.3	4.3	4.4	4.0	3.0	2.5	6.8	2.5	3.7
GNP Price Deflator	5.4	2.6	3.3	3.3	3.4	4.0	4.5	4.7	3.8	3.7	3.7

	Actual	Forecast	Actual	Forecast	
	1985:III	1985: IV	1983-1984	1984-1985	1985-1986
Consumer Spending	7.2%	4.6%	8.6%	7.2%	7.1%
Durable Goods	20.8	-11.5	13.9	7.8	4.2
Nondurable Goods	1.7	5.4	6.9	4.2	6.0
Services	7.6	8.8	8.5	9.2	8.8
Business Capital Spending	0.2	7.1	20.6	9.3	7.2
Structures	-3.5	7.5	16.0	11.0	6.2
Equipment	2.2	7.1	23.4	8.4	7.7
Residential Investment	14.4	8.5	16.4	4.5	1.7
			1984	1985	1986
Change in Inventories	$-8.1b.	$16.0b.	$58.2b.	$16.6b.	$32.8b.
Net Exports of Goods and Services	$-89.2b.	$-92.0b.	$-64.2b.	$-87.4b.	$-95.0b.
			1983-1984	1984-1985	1985-1986
Government Purchases	18.4%	6.1%	9.0%	10.6%	8.2%
Federal	31.2	2.3	9.5	13.4	7.0
Defense	21.4	9.4	10.5	11.4	9.1
Other	62.2	-15.0	6.7	19.5	1.1
State & Local	10.4	8.8	8.7	8.8	9.0
Corporate Profits Before Tax	0.0*	1.9*	16.0	-4.4	8.0
Corporate Profits After Tax	-1.4*	2.5*	14.5	-4.2	7.9
Plant and Equipment Expenditures	1.8	3.5	16.3	8.7	6.1
Real Final Sales#	5.9	1.8	5.0	3.6	3.3
Real Disposable Personal Income	-4.1	3.7	6.7	2.3	2.8

Economic Indicators	Recent Data			Actual	Forecast	
	Aug.	Sept.	Oct.	1983-1984	1984-1985	1985-1986
Consumer Price Index**	2.4%	2.4%	n.a.	4.0%	3.8%	4.4%
Producer Price Index for Finished Goods**	-3.6	-7.2	10.8%	1.7	1.1	3.3
Industrial Production	9.6	-1.2	0.0	11.5	2.3	3.4
Retail Sales##	2.8	2.1	-3.3	10.5	6.3	5.8
				1984	1985	1986
Auto Sales (millions of units, a.r.)	12.6	14.5	9.6	10.4	11.1	10.4
Housing Starts (millions of units, a.r.)	1.75	1.58	n.a.	1.75	1.72	1.64
Unemployment Rate	7.0%	7.1%	7.1%	7.5%	7.2%	6.8%
Merchandise Trade Deficit (a.r.)	$118.8b.	$186.6b.	n.a.	$123.3b.	$147.0b.	$160.0b.

Unless noted otherwise, all data are period-to-period percent changes at annual rates, derived from seasonally adjusted data.

#GNP less change in inventories, both in real terms.

##Monthly percent changes are not annualized.

*Year-over-year percent changes.

**Annual percent changes are December to December (not seasonally adjusted).

$b. = billions a.r. = annual rate F = Forecast

November 15, 1985

Economic Outlook

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Irving Trust

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Economic Research &
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December 1985

The approach of the New Year is an opportune time to consider the performance of the economy during the past 12 months and to assess its outlook from a broad perspective. At the beginning of 1985, forecasts of a recession in 1986 or sooner were widespread because of the serious problems facing the economy: sustained large Federal deficits that were perceived to limit the Federal Reserve's flexibility in attempting to prop up a faltering economy, high real interest rates, and an overvalued dollar. Today, however, the situation has improved dramatically. On a trade-weighted basis, the dollar has depreciated roughly 20% from the highs in early 1985. Interest rates have declined, while inflation has remained relatively subdued. The recent stock market rally has reflected the improved prospects for the economy as well as several other important developments, including a major change in OPEC's strategy and legislation that offers the promise of containing the Federal deficit.

A pickup in economic growth is likely to be evident in 1986, with continued expansion at least through 1987. Real gross national product is expected to rise 3.5% from the fourth quarter of 1985 to the fourth quarter of 1986, compared to an estimated increase of 2.6% in the current period. Because of the depreciation of the dollar, it is likely that inflation rates will be somewhat higher in 1986 than in 1985, offset partly by lower oil prices. The consumer price index is expected to rise 4.6% from December 1985 to December 1986, compared to an estimated rise of 3.8% from December 1984 to December 1985. The modest escalation of inflation and pickup in economic growth may well elicit a tightening in policy by the Federal Reserve, but the Fed would also be keenly aware of the strains this would cause less developed countries in servicing their substantial debt obligations.

If interest rates do rise at some point in 1986, interest-rate-sensitive industries, such as housing and autos, would likely be adversely affected. In view of the high levels of activity in these industries during the past few years, some weakness would be normal at this point in any case. Auto sales are expected to total 10.4 million units in 1986, equal to the 1984 level but down from the estimated 11.0 million units in 1985. Although auto sales will likely decline next year, the sales level would still be relatively high; the aging of the stock of cars in the United States indicates that potential replacement demand is still substantial. Housing starts are expected to total 1.64 million units next year, compared to an estimated total of 1.74 million in 1985 and 1.75 million in 1984.

In sum, the pieces are in place for a continued improvement in economic growth in the months ahead, from the sluggish pace of the first half of 1985. The U.S. industrial sector will likely experience somewhat faster growth next year as a result of the depreciation of the dollar and the progress in correcting inventory imbalances. Industrial production is expected to rise 3.5% in 1986, after rising an estimated 2.2% in 1985 and 11.5% in 1984. Corporate profits will likely show a considerable rebound next year, increasing about 10% (on an after-tax basis) after falling an estimated 2.7% in 1985. Nevertheless, many firms will continue to have to streamline operations to remain competitive with low-wage-cost imports.

Bernard Schoenfeld

Irving Trust

Economic Forecast

Percent Changes at Annual Rates

	Actual				Forecast				Actual	Forecast	
				1985				1986	1983-	1984-	1985-
	I	II	III	IV	I	II	III	IV	1984	1985	1986
Gross National Product	5.6	4.5	6.7	7.1	7.9	8.2	7.6	7.4	10.8	6.2	7.4
Real GNP	0.3	1.9	4.3	4.0	4.4	4.0	3.0	2.5	6.8	2.6	3.8
GNP Price Deflator	5.4	2.6	2.3	3.0	3.4	4.0	4.5	4.7	3.8	3.5	3.5

	Actual	Forecast	Actual	Forecast	
	1985:III	1985:IV	1983-1984	1984-1985	1985-1986
Consumer Spending	7.6%	4.6%	8.6%	7.3%	7.0%
Durable Goods	22.4	-15.8	13.9	7.7	2.6
Nondurable Goods	2.2	10.0	6.9	4.6	6.8
Services	7.6	7.1	8.5	9.1	8.4
Business Capital Spending	1.1	8.8	20.6	9.6	7.6
Structures	1.2	7.5	16.0	11.7	6.8
Equipment	1.1	9.6	23.4	8.4	8.0
Residential Investment	13.8	9.2	16.4	4.5	1.8
			1984	1985	1986
Change in Inventories	$-0.3b.	$18.0b.	$58.2b.	$19.1b.	$32.3b.
Net Exports of Goods and Services	$-104.0b.	$-100.0b.	$-64.2b.	$-93.1b.	$-95.5b.
			1983-1984	1984-1985	1985-1986
Government Purchases	20.4%	1.5%	9.0%	10.6%	7.4%
Federal	36.8	-8.4	9.5	13.2	5.1
Defense	25.1	4.0	10.5	11.5	8.4
Other	74.3	-36.0	6.7	18.5	-4.3
State & Local	10.3	9.0	8.7	8.8	8.9
Corporate Profits Before Tax	3.6*	5.1*	16.0	-2.8	9.9
Corporate Profits After Tax	2.1*	5.7*	14.5	-2.7	9.9
Plant and Equipment Expenditures	1.8	3.5	16.3	8.7	6.2
Real Final Sales#	5.8	2.1	5.0	3.6	3.4
Real Disposable Personal Income	-4.3	3.7	6.7	2.3	2.8

Economic Indicators	Recent Data			Actual	Forecast	
	Sept.	Oct.	Nov.	1983-1984	1984-1985	1985-1986
Consumer Price Index**	2.4%	2.4%	n.a.	4.0%	3.8%	4.6%
Producer Price Index for Finished Goods**	-7.2%	10.8	9.6%	1.7	1.9	3.5
Industrial Production	-0.1	-0.4	0.4	11.5	2.2	3.5
Retail Sales##	2.2	-4.2	1.1	10.5	6.4	5.2
				1984	1985	1986
Auto Sales (millions of units, a.r.)	14.4	9.6	9.8	10.4	11.0	10.4
Housing Starts (millions of units, a.r.)	1.75	1.58	n.a.	1.75	1.74	1.64
Unemployment Rate	7.1%	7.1%	7.0%	7.5%	7.2%	6.6%
Merchandise Trade Deficit (a.r.)	$186.6b.	$137.4b.	n.a.	$123.3b.	$147.0b.	$160.0b.

Unless noted otherwise, all data are period-to-period percent changes at annual rates, derived from seasonally adjusted data.

December 13, 1985

*GNP less change in inventories, both in real terms.
**Monthly percent changes are not annualized.
*Year-over-year percent changes.
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$b. = billions a.r. = annual rate F = Forecast

Economic Outlook

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January 1986

Where's the growth? That's the concern of those who doubt the ability of the U.S. economy to expand through next year without a downturn. The sources of their concern are not hard to identify. If housing starts are not responding to relatively low mortgage rates, if auto sales are propped up only by unsustainable incentive financing programs, if indicators of future capital spending are flashing warning lights, and if fiscal policy may (finally) become less stimulative, where will the growth come from to sustain the recovery? The answer lies primarily in moderate increases in consumer spending, improvement in the U.S. trade position, and the absence of an inventory correction.

The slowdown is evident in the paltry 2.1% growth in real GNP from the third quarter of 1984 to the third quarter of 1985, the latest period for which complete data are available. Consumer spending added 2.5 percentage points to this growth, and capital spending added another percentage point. Real GNP growth was so slow because the movements in inventories and net exports provided substantial negative offsets to the growth in other GNP components. Without these offsets, real growth would have been in excess of the 3.5% contribution provided by consumer spending and business capital spending.

The United States is now in the fourth year of economic recovery. As a comparison, real GNP growth in the fourth and fifth years of the recovery in the second half of the 1970s averaged 3.5% per year. Consumer and business spending together contributed 2.5 percentage points to this growth, and a favorable movement in the U.S. trade position added another 1.4 percentage points. Interestingly, the dollar fell roughly 20% during the late 1970s, the same depreciation as has occurred since the dollar peaked last year. This depreciation will likely lead to a narrowing of the trade deficit (in real terms), with marked improvement during the second half of this year.

In 1986, real consumer spending and business capital spending are expected to provide about 2.5 percentage points to GNP growth, similar to the experience of the late 1970s. Then, as now, some analysts contended that the excessive burden of consumer indebtedness would keep the brakes on consumer spending. In fact, consumer spending kept expanding until credit controls caused it to collapse. Even with the heightened emphasis on containing Federal spending, the government sector will provide a significant contribution to real GNP growth in 1986, as it did last year. In addition, net exports will be less of a drag on growth this year, while the change in inventories will add to rather than detract from the economy's growth. The net result is that real GNP is expected to rise 3.6% in 1986 from the 1985 level, versus an estimated 2.4% increase in 1985. (On a fourth-quarter to fourth-quarter basis, real GNP is expected to rise 3.9% this year, compared to an estimated rise of 2.8% last year.)

In more general terms, despite the considerable problems in particular sectors and industries (farming, steel, textiles, etc.), the economy has a lot going for it this year. Interest rates are lower than year-ago levels, the dollar has declined considerably from its peak, and inventories are generally in better alignment with sales. These developments have set the foundation for improved economic growth in 1986.

Bernard Schoenfeld

Irving Trust

Economic Forecast

Percent Changes at Annual Rates

	Actual				Forecast				Actual	Forecast	
				1985				1986	1983-	1984-	1985-
	I	II	III	IV	I	II	III	IV	1984	1985	1986
Gross National Product	6.9	4.5	5.8	6.6	7.2	8.1	8.6	8.3	11.0	5.8	7.2
Real GNP	3.7	1.1	3.0	3.4	4.0	4.2	3.9	3.5	6.6	2.4	3.6
GNP Price Deflator	3.0	3.3	2.9	3.0	3.1	3.7	4.5	4.7	4.0	3.3	3.5

	Actual	Forecast	Actual	Forecast	
	1985:III	1985: IV	1983-1984	1984-1985	1985-1986
Consumer Spending	6.8%	3.9%	8.7%	6.5%	6.8%
Durable Goods	23.7	-19.1	14.3	8.8	3.1
Nondurable Goods	1.9	7.8	6.8	4.7	6.5
Services	6.0	8.5	8.6	7.3	8.0
Business Capital Spending	3.7	10.2	20.1	11.2	8.0
Structures	1.7	5.7	17.0	15.0	5.4
Equipment	4.8	12.8	21.7	9.2	9.4
Residential Investment	9.7	8.2	17.8	3.5	5.5
			1984	1985	1986
Change in Inventories	$0.2b.	$18.0b.	$67.1b.	$13.1b.	$21.3b.
Net Exports of Goods and Services	$-87.8b.	$-87.0b.	$-59.2b.	$-71.9b.	$-82.3b.
			1983-1984	1984-1985	1985-1986
Government Purchases	20.4%	2.7%	9.0%	10.0%	8.1%
Federal	36.0	-5.1	9.9	11.6	7.0
Defense	23.6	9.0	9.9	10.9	9.2
Other	82.8	-38.0	9.8	13.8	0.2
State & Local	9.6	9.1	8.4	8.8	8.9
Corporate Profits Before Tax	0.4*	3.5*	15.9	-5.0	8.5
Corporate Profits After Tax	0.6*	3.4*	10.9	-2.9	7.7
Plant and Equipment Expenditures	1.1	0.1	16.3	8.4	5.5
Real Final Sales#	5.0	1.9	4.5	4.0	3.5
Real Disposable Personal Income	-4.5%	1.6	5.7	1.6	3.2

Economic Indicators	Recent Data			Actual	Forecast	
	Sept.	Oct.	Nov.	1983-1984	1984-1985	1985-1986
Consumer Price Index**	3.6%	3.6%	3.6%	4.0%	3.8%	4.6%
Producer Price Index for Finished Goods**	-13.2	19.2	7.2	1.7	1.8	3.5
Industrial Production	-0.2	-0.3	0.4	11.5	3.0	2.8
Retail Sales##	2.2	-4.2	1.1	10.5	6.8	5.0
				1984	1985	1986
Auto Sales (millions of units, a.r.)	14.4	9.6	9.8	10.4	11.0	10.4
Housing Starts (millions of units, a.r.)	1.61	1.76	1.55	1.75	1.72	1.64
Unemployment Rate	7.1%	7.1%	7.0%	7.5%	7.2%	6.5%
Merchandise Trade Deficit (a.r.)	$186.6b.	$137.4b.	$164.2b.	$123.3b.	$147.0b.	$160.0b.

Unless noted otherwise, all data are period-to-period percent changes at annual rates, derived from seasonally adjusted data.

January 10, 1986

#GNP less change in inventories, both in real terms.
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$b. = billions a.r. = annual rate F = Forecast

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Economic Outlook

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February 1986

Oil is the big story these days. The price collapse has sparked yet another bond market rally, has raised consumers' hopes about a return to the good old days of low gasoline prices, but has also created severe problems for Mexico and for certain other countries, as well as for certain segments of U.S. industry. On balance, it improves the prospects for sustained economic expansion in the United States with relatively low inflation.

Oil prices had already been declining for several years before the recent plunge. The average refiner acquisition cost of crude oil (which includes both domestic and imported oil) fell from $35.24 per barrel in 1981 to $28.63 in 1984, a decline of 18.8%. During this same period, gasoline prices in the consumer price index fell only 9.9%. Last year, the refiner acquisition cost averaged about $27 a barrel. A refiner acquisition cost of $20-$22 this year seems likely, which would indicate a decline of roughly 20%-25%. Admittedly, some spot prices have declined more, but they have also been more volatile. For example, West Texas intermediate went from $25.75 a barrel in early 1985 to $30-$31 late in the year before plunging to as low as $15.75 recently.

If the 1981-1984 experience is any guide, gasoline prices will decline by only slightly more than half as much as crude oil prices. They may not even decline that much, since a mandated reduction in the lead content of leaded gasoline this year will push up refining costs. Since gasoline prices have a weight of about 5.5% in the consumer price index, the direct effect of a 10%-12% decline in gasoline prices is a reduction in the consumer price index of about seven-tenths of a percentage point from what it would be otherwise. The additional indirect effects of lower oil prices, however, are important and diverse.

As a rough guide to the importance of oil in the U.S. economy, the value of crude oil consumed last year was equal to 3.8% of GNP. A 20%-25% decline in crude oil prices amounts to about 1% of GNP, or a direct reduction in the GNP price deflator of one percentage point from what it would be in the absence of the oil price decline.

In 1985, the consumer price index rose 3.8% (on a December-to-December basis). The decline in oil prices would seem to indicate an inflation rate below last year's except that it will probably be more than offset by the inflationary effects of the depreciation of the dollar, which has amounted to about 20% on a trade-weighted basis since the peak early last year. As a result, the consumer price index is expected to rise about 4.5% from December 1985 to December 1986.

The decline in oil prices increases the odds that real GNP growth will be stronger in 1986 than in 1985. The economy displayed an unusually good performance in December, with retail sales, industrial production, and housing starts all registering sharp increases. January's performance was mixed. Although there was a strong 566,000 gain in nonfarm payroll employment, nonauto retail sales registered a disappointing 0.2% month-to-month decline. Nevertheless, if inventories show modest growth and if the trade deficit narrows in real terms as expected, real GNP in the current quarter may well be rising at the fastest pace since early 1984.

Bernard Schoenfeld

Irving Trust

Economic Forecast

Percent Changes at Annual Rates

	Actual				Forecast				Actual	Forecast
				1985				1986	1983-	1984-	1985-
	I	II	III	IV	I	II	III	IV	1984	1985	1986
Gross National Product	6.9	4.5	5.6	5.9	8.4	7.4	8.4	8.1	11.0	5.8	7.2
Real GNP	1.7	1.1	3.0	2.4	5.4	4.1	1.8	3.2	6.6	2.3	3.7
GNP Price Deflator	5.0	3.3	2.9	3.4	2.9	3.2	4.4	4.7	4.0	3.3	3.4

	Actual	Forecast	Actual	Forecast
	1985: IV	1986: I	1983-1984	1984-1985	1985-1986
Consumer Spending	4.2%	9.2%	8.7%	6.6%	6.7%
Durable Goods	-16.7	16.7	14.3	9.0	4.2
Nondurable Goods	6.7	4.7	8.8	4.6	5.1
Services	9.1	10.5	8.6	7.3	8.6
Business Capital Spending	10.5	8.5	20.1	11.2	7.6
Structures	8.0	6.3	17.0	15.2	5.8
Equipment	10.9	9.6	21.7	9.1	8.6
Residential Investment	21.1	8.0	17.8	3.6	8.1
			1984	1985	1986
Change in Inventories	$22.4b.	$7.0b.	$67.3b.	$9.1b.	$15.5b.
Net Exports of Goods and Services	$-97.2b.	$-94.0b.	$-59.2b.	$-74.4b.	$-87.0b.
			1983-1984	1984-1985	1985-1986
Government Purchases	10.6%	2.4%	9.0%	10.6%	8.3%
Federal	16.0	-2.8	9.4	13.1	8.6
Defense	3.9	4.0	9.9	10.3	7.5
Other	35.6	-19.0	8.8	20.9	12.0
State & Local	6.6	6.5	8.4	8.7	8.0
Corporate Profits Before Tax	14.7	12.0	28.9	-3.0	8.5
Corporate Profits After Tax	12.5	12.5	20.9	-2.9	7.7
Plant and Equipment Expenditures	0.1	5.1	16.3	8.4	2.4
Real Final Sales*	2.1	4.9	4.5	4.0	3.7
Real Disposable Personal Income	-0.2	3.8	5.7	3.6	2.4

Economic Indicators	Recent Data			Actual		Forecast
	Nov.	Dec.	Jan.	1983-1984	1984-1985	1985-1986
Consumer Price Index**	7.2%	4.8%	3.4%	4.0%	3.8%	4.5%
Producer Price Index for Finished Goods**	5.4	6.0	-8.4%	1.3	1.8	2.8
Industrial Production	0.8	0.7	0.3	7.1%	2.2	3.6
Retail Sales**	0.5	1.4	0.1	10.4%	6.3	4.7
				1984	1985	1986
Auto Sales (millions of units, a.r.)	9.4	10.3	9.6	10.4	10.1	10.6
Housing Starts (millions of units, a.r.)	1.97	1.85	1.96	1.74	1.81	1.89
Unemployment Rate	7.0	6.9	6.7	7.5	7.2	6.5
Merchandise Trade Deficit (a.r.)	$122.2b.	$108.8b.	[illegible]	$123.0b.	$122.0b.	$160.0b.

Unless noted otherwise, all data are period-to-period percent changes at annual rates, derived from seasonally adjusted data. [illegible], 1986

*GNP less change in inventories, both in real terms.
**Monthly percent changes are not annualized.
*Year-over-year percent changes.
**Annual percent changes are December-to-December, not seasonally adjusted.
$b. = billions. a.r. = annual rate. F = Forecast.

Economic Outlook

B4750-2

Irving Trust

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Economic Research &
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March 1986

It's hard to imagine a more favorable combination of events for the stock market: a precipitous decline in oil prices, a major bond market rally, and sharp depreciation of the dollar. These developments bode well for the overall economy also. The depreciation of the dollar has improved the growth prospects for numerous industries, while declines in interest rates are supportive of continued economic expansion. In addition, with the notable exception of the auto industry, inventories have generally moved into a comfortable position relative to sales. As a result, real GNP is expected to rise 4.1% from the fourth quarter of 1985 to the fourth quarter of 1986, compared to a 2.3% rise during 1985. The monthly data reported so far this year, however, have been listless.

The economy is poised for an improvement in growth, but it is not yet evident in the monthly numbers. Industrial production fell a sharp 0.6% in February (on a month-to-month basis) after rising only 0.1% in January. Retail sales fell 0.1% in February and 0.2% in January. Auto sales have weakened in March and will likely remain sluggish until the current program of incentive financing is made more attractive. In past periods, a sharp rise in the stock market was usually followed by a pickup in consumer spending. The effects so far are not visible, but the bull market is bound to give a significant boost to consumer spending.

One area of potential weakness in the economic outlook is business capital spending. Nondefense capital goods orders rose only 0.7% last year and fell sharply in January. The pattern among various types of capital goods is uneven. Orders have risen sharply for communication equipment and for aircraft but have fallen for most other types of equipment. The depreciation of the dollar will help domestic capital goods producers as well as their customers, but last year's sluggish economy has still been an important influence in this year's capital spending budgets.

A recent McGraw-Hill survey projects only a 3.4% rise in plant and equipment spending this year. Although this is an improvement from the 1% decline indicated in its survey taken last fall, and although capital spending budgets may well be revised upward during the course of the year, capital spending does seem to be a vulnerable spot in the overall economic outlook. In addition, the proposed elimination of the investment tax credit would remove an important investment incentive. The oil service and equipment industry will be hit particularly hard as oil companies cut their capital and exploration spending in face of lower oil prices. In 1985, the petroleum industry accounted for an estimated 6.9% of all plant and equipment expenditures in the United States and 17.4% of investment by manufacturing companies.

The rally in the bond market is likely to prove a powerful stimulus to the housing industry. Conventional 30-year mortgage rates of 9.5%-9.75% are already being offered in some parts of the country. We have revised our forecast of housing starts upward to 1.8 million units this year, compared to 1.73 million units in 1985. The level would be even higher if not for overbuilding in some parts of the country. The resale market is likely to be especially active as homeowners attempt to get out of the high-rate mortgages of 1980-1984 and take advantage of today's lower rates.

Bernard Schoenfeld

Irving Trust

Economic Forecast

Percent Changes at Annual Rates

	Actual 1985 I	II	III	IV	Forecast 1986 I	II	III	IV	Actual 1983-1984	1984-1985	Forecast 1985-1986
Gross National Product	6.9	4.3	3.8	4.5	7.2	7.1	8.0	8.2	11.0	5.7	6.5
Real GNP	3.7	1.5	3.0	1.2	4.2	4.8	3.8	3.3	6.6	2.3	3.3
GNP Price Deflator	3.1	2.7	2.7	3.3	2.8	2.2	4.0	4.7	4.0	3.1	3.1

	Actual 1985:IV	Forecast 1986:I	Actual 1983-1984	Actual 1984-1985	Forecast 1985-1986
Consumer Spending	4.1%	5.6%	6.7%	6.6%	5.6%
Durable Goods	-0.8	15.0	14.3	9.1	6.0
Nondurable Goods	0.6	3.0	6.8	4.6	3.7
Services	5.7	6.2	6.0	7.3	6.9
Business Capital Spending	10.2	6.8	20.1	11.2	6.1
Structures	1.6	4.4	17.0	13.4	5.9
Equipment	14.4	7.0	21.2	9.9	6.2
Residential Investment	10.5	12.6	17.8	5.6	11.7

	1984	1985	1986
Change in Inventories	$-25.0b.	$67.1b.	$17.5b.
Net Exports of Goods and Services	$-106.3b.	$-98.2b.	$-89.0b.

	1983-1984	1984-1985	1985-1986
Government Purchases	9.0%	10.7%	8.0%
Federal	8.3	13.5	9.0
Defense	9.8	10.3	7.5
Other	5.9	22.4	13.1
State & Local	9.6	8.5	7.3
Corporate Profits Before Tax	19.8	-6.0	9.1
Corporate Profits After Tax	19.0	-4.4	9.0
Plant and Equipment Expenditures	14.3	8.4	3.8
Real Final Sales*	6.3	3.0	3.2
Real Disposable Personal Income	4.1	1.6	2.4

Economic Indicators	Dec.	Jan.	Recent Data Feb.	Actual 1983-1984	1984-1985	Forecast 1985-1986
Consumer Price Index**	4.6%	3.6%	N.A.	4.3%	3.8%	3.5%
Producer Price Index for Finished Goods**	0.3	-0.4	-0.2	1.7	1.8	0.9
Industrial Production	0.8	0.1	-0.1	6.5	2.2	3.2
Retail Sales**	1.9	-0.2	-0.1	10.4	6.3	4.7

	1984	1985	1986
Auto Sales (millions of units, a.r.)	11.3	10.7	10.7
Housing Starts (millions of units, a.r.)	1.76	1.73	1.80
Unemployment Rate	7.5%	7.2%	6.6%
Merchandise Trade Deficit (a.r.)	$[78.4b., $101.6b.	N.A.	$123.2b.	$144.6b.	$155.0b.

Unless noted otherwise, all data are period-to-period percent changes at annual rates, derived from seasonally adjusted data.

*GNP less change in inventories, both in real terms.
**Monthly percent changes are not annualized.

*Year-over-year percent changes.
**Annual percent changes are December to December (not seasonally adjusted).

March 14, 1986

$b. = billions a.r. = annual rate F = Forecast

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Economic Outlook

Irving Trust

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Economic Research &
Planning Division

April 1986

Low oil prices are causing oil companies to cut back wherever possible, while numerous signs of weakness in the economy are still evident. Nevertheless, the combination of substantial dollar depreciation, a precipitous decline in oil prices, and the lowest interest rates since 1977-1978 indicates that stronger economic growth still lies ahead. Real GNP is now expected to rise 3.6% from the fourth quarter of 1985 to the fourth quarter of 1986, somewhat less than previously projected but still higher than the comparable 2.1% increase last year.

One highly visible trouble spot of late is the auto industry. GM recently announced the biggest cutback in production since 1982. Dealers' inventories of GM cars are estimated to be about 85 days' supply, compared to a "normal" supply of about 60 days. Chrysler's supply is also well above normal, while Ford's supply is normal. As expected, a new round of more aggressive incentive financing has just been introduced by GM.

In 1985, auto output accounted for 2.9% of real GNP, up from 2.1% in 1982 but hardly changed from earlier years with strong sales. Although this may not seem to be a large component of GNP, developments in the auto industry have influenced the overall pace of GNP growth. Rebounds in auto output added slightly more than one percentage point to real GNP growth in the first and third quarters of last year, while sharp declines in auto output in the second and fourth quarters similarly reduced real GNP growth by slightly more than one percentage point. In the current quarter, a reduction in auto output will probably reduce real GNP growth by more than one percentage point as production is curtailed to reduce excessive inventories.

With several years of high auto sales behind us, it is not surprising that sales are faltering; the pent-up demand carried over from the recession has long been satisfied. Nevertheless, the auto makers do have one important factor in their favor. Despite high sales levels, the stock of cars has continued to age during the last few years, to the point that the average age of cars in use rose to 7.6 years in 1985, the highest since 1950. With more than 115 million cars on the road today, potential replacement demand is substantial, although the decision to purchase a car is still highly discretionary. Auto sales are expected to total 10.7 million units this year and 10.1 million next year, compared to 11.1 million in 1985. Domestic sales are expected to decline from 8.3 million units in 1985 to 7.8 million in 1986 and 7.2 million in 1987.

Although low oil prices are welcomed by most consumers, the economy has not seemed to respond yet to the effective net stimulus. To put the price decline into perspective, a 30%-40% decline in gasoline and heating oil prices translates to a savings of (quite coincidentally) about $30-$40 per household per month. This is simply too small a sum to influence spending decisions right away. Over time, however, as families' checking account balances begin to look better than anticipated or as outstanding credit card balances are worked down, spending could perk up, though not necessarily on big ticket items. Even the March retail sales report of a month-to-month decline of 0.8% was not as bleak as it may seem. Excluding autos and gasoline, sales rose by a respectable 0.6%, helped along by seasonably warm weather.

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Irving Trust

Economic Forecast

Percent Changes at Annual Rates

	Actual 1985				Forecast 1986				Actual	Actual	Forecast
	I	II	III	IV	I	II	III	IV	1983-1984	1984-1985	1985-1986
Gross National Product	6.9	4.5	5.8	4.3	5.0	5.1	7.1	8.8	11.0	5.7	5.4
Real GNP	3.7	1.1	3.0	0.7	3.0	3.2	4.3	4.0	6.6	2.2	2.7
GNP Price Deflator	3.0	3.3	2.9	3.3	2.1	1.8	2.6	4.7	4.0	3.3	2.7

	Actual 1985: IV	Forecast 1986: I	Actual 1983-1984	Actual 1984-1985	Forecast 1985-1986
Consumer Spending	4.5%	4.0%	8.7%	6.6%	2.4%
Durable Goods	-14.1	3.1	14.3	9.2	0.8
Nondurable Goods	6.2	-1.8	6.8	4.6	1.6
Services	4.1	6.3	8.6	7.3	3.4
Business Capital Spending	12.2	-0.9	20.1	11.3	2.7
Structures	10.0	11.7	17.0	15.3	3.4
Equipment	13.5	-7.0	21.7	9.2	2.3
Residential Investment	13.3	18.9	17.8	3.6	10.7
			1984	1985	1986
Change in Inventories	$-4.3b.	$6.0b.	$67.4b.	$7.5b.	$5.4b.
Net Exports of Goods and Services	$-133.4b.	$-101.9b.	$-59.2b.	$-78.5b.	$-124.0b.
			1983-1984	1984-1985	1985-1986
Government Purchases	12.4%	-3.8%	9.0%	10.7%	4.0%
Federal	23.8	-14.3	9.9	13.6	5.9
Defense	3.3	10.1	9.9	10.5	6.5
Other	97.4	-43.8	9.8	33.2	4.1
State & Local	4.2	5.8	8.4	8.5	2.4
Corporate Profits Before Tax	5.2*	11.3*	18.9	-4.6	11.0
Corporate Profits After Tax	6.3*	11.2*	10.9	-2.2	9.5
Plant and Equipment Expenditures	0.1*	5.3*	16.3	8.4	2.0
Real Final Sales#	1.1	1.8	4.2	1.9	2.8
Real Disposable Personal Income	2.1	1.2	3.7	1.6	3.4

Economic Indicators	Recent Data Jan.	Feb.	Mar.	Actual 1983-1984	Actual 1984-1985	Forecast 1985-1986
Consumer Price Index**	3.6%	+4.8%	n.a.	4.0%	3.8%	2.7%
Producer Price Index for Finished Goods**	-8.4	-10.2	-13.2	1.7	1.8	0.1
Industrial Production	0.1	-0.5	n.a.	11.3	2.2	2.8
Retail Sales##	-0.2	0.1	-0.8	10.3	6.5	3.2
				1984	1985	1986
Auto Sales (millions of units, a.r.)	11.3	10.3	n.a.	10.4	11.1	10.7
Housing Starts (millions of units, a.r.)	2.06	1.99	n.a.	1.75	1.74	1.85
Unemployment Rate	6.7%	6.6%	6.6%	7.5%	7.2%	6.7%
Merchandise Trade Deficit (a.r.)	$107.3b.	$140.9b.	n.a.	$123.6b.	$144.6b.	$155.0b.

Unless noted otherwise, all data are period-to-period percent changes at annual rates, derived from seasonally adjusted data.

April 14, 1986

#GNP less change in inventories, both in real terms
*Year-over-year percent changes
##Monthly percent changes are not annualized
**Annual percent changes are December to December (not seasonally adjusted)

$b. = billions a.r. = annual rate F = Forecast

Economic Outlook

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May 1986

The economy is being tugged and pulled in opposite directions by various sectors. Housing is a strong spot now, while exports are being boosted by the depreciation of the dollar. Industrial production continues to fall, however, with much of the weakness in oil-related activities. Despite the softness in the industrial sector, real GNP rose at a 3.2% annualized rate in the first quarter and is estimated to be rising at a 2.8% rate in the current quarter. Given the substantial depreciation of the dollar, the generally favorable effects of low oil prices, and the declines in interest rates since mid-1984, it seems likely that the economy will be experiencing stronger growth later this year and early next year.

Early in 1985, when the dollar was at its recent peak, the strains in the U.S. industrial sector were severe. Because of the strong dollar, the market shares of numerous industries were being eroded by imports into the United States, while their products had become uncompetitive abroad. The depreciation of the dollar since then has turned U.S. exports around. Merchandise exports in real terms fell steadily from the fourth quarter of 1984 through the third quarter of 1985. They then rose at a 9.6% annualized rate in the fourth quarter of last year and at an 18.0% rate in the first quarter of this year--a striking reversal. Moreover, despite the volatility of the merchandise trade data, the first quarter rebound was not just a fluke; every major category of exports rose.

The outlook seems particularly bright for narrowing our trade deficit with Western Europe. The dollar has fallen slightly more than a third against several Western European currencies. Moreover, the recent improvement in economic growth prospects in Western Europe indicates a more favorable outlook for U.S. exports to this region. Although the U.S. ran a trade deficit of $27.4 billion in 1985 with Western Europe, as recently as 1982 the U.S. had a trade surplus of $5.3 billion with the region. One category that may show particular improvement in the trade balance with Western Europe is industrial materials, which are especially sensitive to shifts in exchange rates.

Business capital spending is now a drag on the economy. Real business capital spending fell 13.6% at an annual rate in the first quarter, after rising 9.7% in 1985 and 19.5% in 1984. The declines among various categories of equipment were broadly based, but petroleum-related activities were responsible for the intensity of the decline. Oil companies are continuing to pare back their capital and exploration budgets. As one sign of the shift in the fortunes of the oil service industry, the number of rotary rigs in operation in the United States fell from about 4,500 late in 1981 to 1,950 in December 1985 and then plunged to 825 recently. In general, the outlook for capital spending near-term remains guarded, but at least the non-petroleum components may face improved demand if overall economic growth picks up later this year, as expected. The outlook has become cloudier of late because of recent developments in tax reform. It now appears that the investment tax credit will indeed be eliminated, but its effect may be partially offset by a more accelerated depreciation schedule for equipment. Although tax reform has definite positive attributes, whatever legislation is finally enacted will at least initially be detrimental to certain types of capital expenditures.

Bernard Schoenfeld

Irving Trust

Economic Forecast

Percent Changes at Annual Rates

	Actual					Forecast			Actual	Forecast	
	1985				1986				1983-	1984-	1985-
	I	II	III	IV	I	II	III	IV	1984	1985	1986
Gross National Product	6.9	4.5	5.8	4.3	5.8	4.6	7.3	8.8	11.0	5.7	5.6
Real GNP	3.7	1.1	3.0	0.7	3.2	2.8	4.2	4.0	6.6	2.2	2.7
GNP Price Deflator	3.0	3.3	2.9	3.3	2.5	1.9	3.0	4.7	4.0	3.3	2.9

	Actual	Forecast	Actual	Forecast
	1986: I	1986: II	1983-1984	1984-1985	1985-1986
Consumer Spending	5.5%	5.3%	8.7%	6.6%	5.7%
Durable Goods	0.4	7.7	14.3	9.2	2.0
Nondurable Goods	-1.8	2.1	6.8	4.6	4.8
Services	7.5	6.7	8.6	7.3	7.2
Business Capital Spending	-10.1	-2.8	20.1	11.3	0.3
Structures	-0.7	-0.5	17.0	15.3	2.2
Equipment	-14.9	-4.1	21.7	9.2	-0.7
Residential Investment	13.5	20.3	17.8	3.6	14.4
			1984	1985	1986
Change in Inventories	$29.7b.	$12.0b.	$67.1b.	$7.5b.	$18.9b.
Net Exports of Goods and Services	$-95.1b.	$-83.3b.	$-59.2b.	$-78.5b.	$-82.3b.
			1983-1984	1984-1985	1985-1986
Government Purchases	-10.8%	6.2%	9.0%	10.7%	5.1%
Federal	-28.1	8.0	9.9	13.6	3.1
Defense	- 7.8	4.9	9.9	10.5	4.6
Other	-63.2	18.0	9.8	23.2	-1.4
State & Local	5.4	4.8	8.4	8.5	6.3
Corporate Profits Before Tax	4.2F*	7.6*	15.9	-5.2	7.2
Corporate Profits After Tax	4.0F*	7.0*	10.9	-2.6	6.7
Plant and Equipment Expenditures	-6.9F	10.7	16.3	8.4	2.3
Real Final Sales#	-0.4	4.7	4.5	3.9	2.4
Real Disposable Personal Income	5.6	3.5	5.7	1.6	3.4

Economic Indicators	Recent Data			Actual	Forecast
	Jan.	Feb.	Mar.	1983-1984	1984-1985	1985-1986
Consumer Price Index**	3.6%	-4.8%	-4.8%	4.0%	3.8%	2.7%
Producer Price Index for Finished Goods**	-8.4	-19.2	-13.2	1.7	1.8	0.1
Industrial Production	0.2	-0.7	-0.5	11.5	2.2	2.1
Retail Sales##	-0.2	0.1	-0.8	10.5	6.5	3.8
				1984	1985	1986
Auto Sales (millions of units, a.r.)	11.5	10.7	9.6	10.4	11.1	10.7
Housing Starts (millions of units, a.r.)	2.03	1.99	1.95	1.75	1.73	1.88
Unemployment Rate	6.7%	7.3%	7.2%	7.5%	7.2%	6.7%
Merchandise Trade Deficit (a.r.)	$197.5b.	$149.9b.	$174.3b.	$127.6b.	$144.6b.	$155.0b.

Unless noted otherwise, all data are period-to-period percent changes at annual rates, derived from seasonally adjusted data.

#GNP less change in inventories, both in real terms.
##Monthly percent changes are not annualized.
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$b. = billions a.r. = annual rate F = Forecast

May 12, 1986

Economic Outlook

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June 1986

Throughout this business expansion, analysts have been trying to put the recovery into a neat, predictable category. So far, such categorization has proved elusive. Even well after the recovery began, forecasts of a slow recovery were presented, with the unemployment rate moving below 10% only gradually. Instead, the first year and a half after the end of the recession proved to be the very model of a classic, V-shaped recovery, with the unemployment rate dropping below 8% early in 1984. The recovery then seemed so buoyant that concerns shifted to whether the Federal Reserve could bring the economy to a "soft landing" without winding up with a recession. A soft landing was indeed achieved. Now we have all been waiting for the next lift-off, but the flight has been repeatedly delayed. Nevertheless, the odds still favor a pickup in economic activity later this year. If it does materialize, then the current expansion will once again generally look normal in comparison to earlier periods. At the same time, it is unique in important respects. In particular, if the expansion continues for several more years (as we expect), it will prove to be the longest peacetime recovery on record (as far back as the 1850s).

One reason for expecting an improvement in economic activity is the anticipated narrowing of the real merchandise trade deficit as a result of the depreciation of the dollar. The enlargement of the trade deficit was responsible for reducing real GNP growth from the fourth quarter of 1984 to the fourth quarter of 1985 by a full percentage point. Real GNP rose only 2.1% during this period. Other things being equal, a simple shift from minus one percentage point to plus one would make this a 4% growth economy instead of a 2% growth economy. Eventually, the declines in oil prices should also prove generally favorable for the economy. So far, however, most of the visible effects have been negative. For example, the unemployment rate in Texas has risen from 6.4% in January to 9.6% in May.

Several of the economic indicators released in May were surprisingly strong. For example, industrial production rose 0.4% in April (initially reported at +0.2%) following a series of declines, while the index of leading economic indicators rose by a sharp 1.5%. The favorable reports in the economy contributed to a bearish tone in the bond market. Now the latest data have once again highlighted the weakness in the economy. For example, retail sales declined 0.1% in May from the April level, while industrial production fell 0.6%.

The key area of vulnerability in our forecast is capital spending, which has already been falling so far this year. Fortunately, inflation remains relatively low even aside from the effect of oil prices. Some prices have been rising as a result of the depreciation of the dollar, and additional upward pressures from this area can be expected. Most commodity prices remain weak, however, as less developed countries maintain high levels of production to meet their debt obligations. In the late 1970s, when commodity prices were soaring, most nations, including the LDCs, were experiencing strong growth; today, growth among major regions of the world is uneven. These aspects of the economy--financial strains, uneven growth, and overcapacity in many types of commodities--indicate that this expansion has an extraordinary amount of running room.

Bernard Schoenfeld

Irving Trust

Economic Forecast

Percent Changes at Annual Rates

	1985 I	1985 II	1985 III	1985 IV	Actual 1986 I	Forecast 1986 II	Forecast 1986 III	Forecast 1986 IV	Actual 1983-1984	Actual 1984-1985	Forecast 1985-1986
Gross National Product	6.9	4.5	5.8	4.3	5.7	4.1	7.8	8.7	11.0	5.7	5.5
Real GNP	3.7	1.1	3.0	0.7	2.9	2.5	4.1	4.0	6.6	2.2	2.6
GNP Price Deflator	3.0	3.3	2.9	3.3	2.9	1.5	3.4	4.7	4.0	3.3	2.9

	Actual 1986: I	Forecast 1986: II	Actual 1983-1984	Actual 1984-1985	Forecast 1985-1986
Consumer Spending	5.2%	3.2%	8.7%	6.6%	5.2%
Durable Goods	1.2	8.1	14.3	9.2	2.6
Nondurable Goods	-1.8	-2.4	6.8	4.6	3.4
Services	7.6	5.8	8.6	7.3	7.2
Business Capital Spending	-10.4	1.1	20.1	11.3	1.1
Structures	-11.8	0.2	17.0	15.3	-0.6
Equipment	-9.8	1.7	21.7	9.2	2.1
Residential Investment	12.4	22.2	17.8	3.6	14.2
			1984	1985	1986
Change in Inventories	$39.9b.	$13.0b.	$67.1b.	$7.5b.	$23.1b.
Net Exports of Goods and Services	$-105.8b.	$-83.8b.	$-59.2b.	$-78.5b.	$-81.4b.
			1983-1984	1984-1985	1985-1986
Government Purchases	-9.4%	6.8%	9.0%	10.7%	5.1%
Federal	-25.8	7.7	9.9	13.6	3.2
Defense	-5.9	6.7	9.9	10.5	4.8
Other	-60.8	10.7	9.8	23.2	-1.5
State & Local	5.6	6.2	8.4	8.5	6.6
Corporate Profits Before Tax	-1.5*	1.8*	15.9	-5.2	1.9
Corporate Profits After Tax	0.3*	1.2*	10.9	-2.6	1.8
Plant and Equipment Expenditures	-20.1	4.0	16.3	9.0	-1.4
Real Final Sales#	-1.7	5.4	4.5	3.9	2.7
Real Disposable Personal Income	5.5	9.9	5.7	1.6	4.1

Economic Indicators	Recent Data Mar.	Apr.	May	Actual 1983-1984	Actual 1984-1985	Forecast 1985-1986
Consumer Price Index**	-4.8%	-3.6%	n.a.	4.0%	3.8%	2.7%
Producer Price Index for Finished Goods**	-13.2	-7.2	7.2	1.7	1.8	-0.2
Industrial Production	-11.5	5.8	-7.7	11.5	2.2	0.9
Retail Sales##	-0.4	0.4	-0.1	10.5	6.5	3.0
				1984	1985	1986
Auto Sales (millions of units, a.r.)	9.6	11.1	11.3	10.4	11.1	10.8
Housing Starts (millions of units, a.r.)	1.96	2.04	1.89	1.75	1.73	1.89
Unemployment Rate	7.2%	7.1%	7.3%	7.5%	7.2%	7.0%
Merchandise Trade Deficit (a.r.)	$174.3b.	$144.9b.	n.a.	$127.6b.	$144.6b.	$152.0b.

Unless noted otherwise, all data are period-to-period percent changes at annual rates, derived from seasonally adjusted data.

June 18, 1986

#GNP less change in inventories, both in real terms.
##Monthly percent changes are not annualized.
*Year-over-year percent changes.
**Annual percent changes are December to December (not seasonally adjusted).
$b. = billions a.r. = annual rate F = Forecast

B4740-2

Economic Outlook

Irving Trust

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Economic Research &
Planning Division

July 1986

The recent reduction in the discount rate from 6.5% to 6%, the lowest rate since early 1978, is further confirmation of the hesitant performance of the economy so far this year. Nevertheless, the cumulative effects of declining interest rates, continued low oil prices, and substantial dollar depreciation will eventually lead to an acceleration in economic growth, although the process does appear to be protracted.

We are often asked: Does a reduction in interest rates really matter? Can any response be detected? To assess the importance of the declines in interest rates, bear in mind that the current lackluster performance of the economy is no indication that prior reductions in rates had no effect. To provide a precise answer, we would have to know the condition of the economy in the absence of these rate cuts. Presumably, it would be considerably weaker than its current state. Although some sectors of the economy seem little affected by the declines in rates, the auto and housing industries have been definite beneficiaries.

Auto sales totaled 11.2 million units at an annual rate in the second quarter, slightly above last year's level. The declines in interest rates have enabled the auto manufacturers to use incentive financing programs (or rebates in some cases) to promote sales. Although the programs have been costly for the auto manufacturers, sales have remained strong. Excluding last year, the second quarter's sales were the highest for any quarter since early 1979. As a hypothetical case, if the Federal funds rate were still at the recent peak of 11.4% (registered in the third quarter of 1984), it would be difficult to envision sales at the current level. Auto sales are expected to total 10.9 million units this year and 10.3 million units in 1987.

The housing industry has certainly been helped by the declines in interest rates. In 1984, a rise in mortgage rates from 11.55% (the average for a fixed-rate mortgage) in the spring to 12.25% in the fall contributed to a drop in housing starts, from 1.9 million units at an annual rate in the first half of the year to 1.6 million units in the fourth quarter. The general downward trend in mortgage rates since then led to a surge in housing starts, which averaged 2 million units during the first four months of 1986. Mortgage rates rose this year from about 10% in early spring to 10.7% in June, but are edging downward once again. Declines in mortgage rates from current levels will tend to support housing, but concerns about tax reform are already depressing multi-family starts. Under the House and Senate proposals, beginning next year investment in apartment buildings and other types of structures would be written off over a much longer period than under current law, without the benefit of accelerated depreciation. Housing starts are expected to total 1.89 million units this year and 1.70 million units in 1987, compared to 1.74 million units in 1985.

In sum, the declines in interest rates have been helpful in supporting the business expansion, but the effects have been uneven. Although real interest rates are still higher than at many times in the past, lower rates will not solve the fundamental problems for some industries, such as the oil industry. In addition, despite the sense that overall economic performance is below par, some sectors, such as consumer spending, are actually generating stronger growth than is generally perceived.

Bernard Schoenfeld

Irving Trust

Economic Forecast

Percent Changes at Annual Rates

	Actual	1986			1987			Forecast	Actual	Forecast	
	I	II	III	IV	I	II	III	IV	1984-1985	1985-1986	1986-1987
Gross National Product	5.7	3.7	7.5	8.2	8.1	8.5	7.8	7.3	5.7	5.4	7.7
Real GNP	2.9	2.2	4.0	4.1	3.9	4.0	3.7	2.7	2.2	2.5	3.8
GNP Price Deflator	2.9	1.4	3.3	4.0	4.1	4.3	4.0	4.5	3.3	2.8	3.9

	Actual	Forecast	Actual	Forecast	
	1986: I	1986:II	1984-1985	1985-1986	1986-1987
Consumer Spending	5.2%	5.9%	6.6%	5.8%	7.4%
Durable Goods	1.2	18.6	9.2	5.2	7.7
Nondurable Goods	-1.8	-0.9	4.6	3.6	7.2
Services	7.6	7.4	7.3	7.4	7.4
Business Capital Spending	-10.4	-0.2	11.3	0.9	1.4
Structures	-11.8	0.2	15.3	-0.6	0.5
Equipment	-9.8	-0.3	9.2	1.7	1.9
Residential Investment	12.4	18.7	3.6	13.1	7.0
			1985	1986	1987
Change in Inventories	$39.9b.	$11.7b.	$7.5b.	$22.4b.	$25.0b.
Net Exports of Goods and Services	$-105.8b.	$-100.9b.	$-78.5b.	$-98.2b.	$-57.3b.
			1984-1985	1985-1986	1986-1987
Government Purchases	-9.4	7.0	10.7%	5.1%	6.9%
Federal	-25.8	8.0	13.6	3.2	8.1
Defense	-5.9	6.7	10.5	4.8	7.9
Other	-60.8	11.7	23.2	-1.4	8.6
State & Local	5.6	6.3	8.5	6.5	6.0
Corporate Profits Before Tax	-1.5*	1.4*	-5.2	0.4	9.0
Corporate Profits After Tax	0.3*	0.8*	-2.6	0.3	8.0
Plant and Equipment Expenditures	-20.1	4.0	9.0	-1.4	-0.9
Real Final Sales#	-1.7	5.2	3.9	2.1	3.7
Real Disposable Personal Income	5.5	7.9	1.6	3.7	3.2

Economic Indicators	Recent Data			Actual	Forecast	
	Apr.	May	June	1984-1985	1985-1986	1986-1987
Consumer Price Index**	-3.6%	-2.4%	n.a.	3.8%	2.5%	4.4%
Producer Price Index for Finished Goods**	-7.2	7.2	0.0%	1.8	-0.3	3.9
Industrial Production	0.6	-0.4	-0.5	2.2	0.5	2.2
Retail Sales##	0.9	0.7	0.2	6.4	4.5	7.3
				1985	1986	1987
Auto Sales (millions of units, a.r.)	11.1	11.3	11.0	11.1	10.9	10.3
Housing Starts (millions of units, a.r.)	2.04	1.86	1.85	1.74	1.89	1.70
Unemployment Rate	7.1%	7.3%	7.1%	7.2%	7.0%	6.5%
Merchandise Trade Deficit (a.r.)	$144.9b.	$170.5b.	n.a.	$148.5b.	$155.0b.	$130.0b.

Unless noted otherwise, all data are period-to-period percent changes at annual rates, derived from seasonally adjusted data.

July 17, 1986

#GNP less change in inventories, both in real terms.
##Monthly percent changes are not annualized.
*Year-over-year percent changes.
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$b. = billions a.r. = annual rate F = Forecast

Economic Outlook

Irving Trust

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Economic Research &
Planning Division

August 1986

The newspapers are full of articles these days about bankruptcies, losses, and earnings declines. With all of the worrisome earnings reports, concerns have been raised that the long-awaited pickup in economic activity will not occur anytime soon. With the past declines in interest rates and the substantial depreciation of the dollar, it seems that the long-awaited acceleration in real GNP growth should not be far off. Moreover, despite the paltry 0.6% annualized rise in real GNP in the second quarter, real GNP has increased 2.5% at an annual rate during the last two years. This is distinctly below normal for a recovery period but only slightly below the economy's 3.0% long-term growth rate. (After a recent major data revision, real GNP growth during 1985 is now estimated to be 0.8% higher than previously indicated.) With the assumption that the real trade balance shows moderate improvement through next year, real GNP is expected to rise 3.6% from the fourth quarter of 1986 to the fourth quarter of 1987.

According to a recent Department of Commerce report, after-tax profits in the second quarter rose 4.1% from the first-quarter level and 11.1% from a year ago. Profits are still 3.8% below the peak level reached in the first quarter of 1984. Despite a sharp rebound in profits during the initial stage of this expansion--a 40.4% gain in the first 15 months--profits have never recovered to the all-time peak reached in the first quarter of 1980. Since the Department of Commerce uses IRS data as the basis for the comprehensive profits data it publishes, the shift to a highly accelerated depreciation schedule in 1981 tended to restrain growth in aggregate profits in government reports on both a before-tax and an after-tax basis. Consequently, the "quality" of profits is actually better than the unadjusted numbers indicate.

The Department of Commerce also provides data on profits adjusted so that inventories used in production are valued at current cost and depreciation is valued at estimated current replacement cost. On this basis, after-tax profits rose 140.2% from the bottom of the last recession to the first quarter of this year, a record gain to a record level, but then fell 3.5% from the first to the second quarter. Despite this favorable assessment of operating profits, companies have lost billions of dollars in this recovery. Important industries are experiencing wrenching adjustments that transcend normal business cycle fluctuations, and their problems will be visible for years to come.

Many corporations have been so attentive to containing costs as reported profits have stagnated that they will benefit dramatically from a pickup in demand. Some companies are already showing the positive effects of dollar depreciation. A potential problem for profits this year is that many firms will have to restate net income because of the pending loss of the investment tax credit retroactive to January 1, 1986, as indicated in the Conference Committee's tax reform proposal. In its budget presented early this year, the Administration estimated the revenue loss due to the use of the investment tax credit by corporations in fiscal year 1986 at $22.3 billion. Although estimates presented in various legislative proposals are significantly less than this amount, the loss of the investment tax credit would mean that the anticipated rise of 8.9% in after-tax profits this year without a change in law will become a 3%-6.5% decline after restatement because of tax reform.

Bernard Schoenfeld

Irving Trust

Economic Forecast

Percent Changes at Annual Rates

	Actual		1986		Forecast 1987				Actual 1984-	Forecast 1985-	Forecast 1986-
	I	II	III	IV	I	II	III	IV	1985	1986	1987
Gross National Product	6.2	3.0	7.3	8.3	8.2	8.5	8.3	7.3	6.2	5.8	7.3
Real GNP	3.8	0.6	3.8	4.2	4.0	4.0	3.8	2.5	2.7	2.8	3.7
GNP Price Deflator	2.5	2.5	3.2	4.0	4.0	4.3	4.4	4.6	3.4	2.9	3.5

	Actual 1986:II	Forecast 1986:III	Actual 1984-1985	Forecast 1985-1986	Forecast 1986-1987
Consumer Spending	5.7%	6.3%	7.1%	6.2%	6.9%
Durable Goods	17.6	2.5	8.5	4.6	6.8
Nondurable Goods	-0.3	4.5	4.0	3.7	6.1
Services	6.7	8.6	8.9	8.2	7.5
Business Capital Spending	-2.3	5.5	10.0	0.7	4.3
Structures	-32.3	-3.9	11.1	-7.6	-2.6
Equipment	16.0	10.0	9.4	4.9	7.4
Residential Investment	21.9	16.5	5.7	13.8	6.9
			1985	1986	1987
Change in Inventories	$12.5b.	$20.0b.	$11.1b.	$25.6b.	$33.3b.
Net Exports of Goods and Services	$-100.2b.	$-108.0b.	$-78.9b.	$-101.6b.	$-90.3b.
			1984-1985	1985-1986	1986-1987
Government Purchases	11.6%	8.6%	11.2%	6.3%	7.4%
Federal	13.4	12.9	13.7	4.9	8.9
Defense	18.6	13.8	10.4	8.2	9.3
Other	-0.9	10.2	24.3	-4.4	7.7
State & Local	10.4	5.5	9.3	7.3	6.3
Corporate Profits Before Tax	8.5*	4.1*	-5.3	5.5	10.1
Corporate Profits After Tax	11.1*	8.7*	-6.4	8.7	10.6
Plant and Equipment Expenditures	-1.0F	3.0	9.0	-2.3	4.0
Real Final Sales#	3.8	3.1	4.2	2.4	3.5
Real Disposable Personal Income	7.4	3.3	2.3	4.1	3.4

Economic Indicators	Recent Data May	June	July	Actual 1984-1985	Forecast 1985-1986	1986-1987
Consumer Price Index**	2.4%	6.0%	n.a.	3.7%	2.5%	4.2%
Producer Price Index for Finished Goods**	7.2	0.0	-4.8%	2.1	-1.3	3.6
Industrial Production	-0.5	-0.3	-0.1	2.2	0.3	2.0
Retail Sales##	0.8	-0.1	0.1	6.4	4.0	6.0
				1985	1986	1987
Auto Sales (millions of units, a.r.)	11.3	11.1	10.7	11.1	10.9	10.3
Housing Starts (millions of units, a.r.)	1.86	1.85	n.a.	1.74	1.88	1.70
Unemployment Rate	7.3%	7.1%	6.9%	7.2%	7.0%	6.5%
Merchandise Trade Deficit (a.r.)	$170.5b.	$170.0b.	n.a.	$148.5b.	$155.0b.	$130.0b.

Unless noted otherwise, all data are period-to-period percent changes at annual rates, derived from seasonally adjusted data.

#GNP less change in inventories, both in real terms.
##Monthly percent changes are not annualized.
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$b. = billions a.r. = annual rate F = Forecast

August 19, 1986

Economic Outlook

Irving Trust

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Economic Research &
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September 1986

Both the bond market and the stock market seem to have acquired a case of the jitters. The outlook for the economy has become particularly muddled. Earlier this year the possibilities were well defined: The economy would either improve in response to past declines in interest rates and the dollar, or it would plod along with unsatisfactory real growth, which would cause the Federal Reserve to push interest rates (and the dollar) lower. The latter case was the one that materialized.

Today the concerns seem to be moving in opposite directions. The skittishness in the bond market is a reaction to recent signs of improvement in the economy, such as widespread gains in manufacturing employment in August and the bottoming out of the rig count. In addition, oil prices and prices of certain other commodities have risen from their recent lows, while rapid growth in the broader monetary aggregates M2 and M3 makes it difficult for the Fed to justify additional stimulus. At the other end of the spectrum, some are concerned that the economy is still fundamentally weak but that the Fed may not act decisively enough to lift it out of the doldrums.

The current round of rock-bottom incentive financing for autos will make it especially difficult to get a true reading on the economy's momentum since it will likely produce a roller-coaster pattern of auto sales. It seems to us that the declines in interest rates and the dollar should eventually lead to an improvement in economic growth, although trouble spots will remain quite visible. Because of the loss of the investment tax credit, pending tax reform presents special risks for capital spending next year. In addition, the corporate tax rate will decline from the current rate of 46% to a blended rate of only 40% in 1987 before declining to 34% in 1988. Real GNP is expected to rise 2.9% from the fourth quarter of 1985 to the fourth quarter of 1986 and 3.5% next year.

Low inflation this year has given the Fed considerable leeway to reduce interest rates. In the summer of 1984, just before interest rates began to decline, the Federal funds rate was about 11.5%. Since the year-over-year increase in the consumer price index at that time was 4.2%, the Fed had ample room to push rates lower. Today, with the Federal funds rate near 5.75% and the comparable increase in the CPI at 1.6%, the Fed would seem to have sufficient maneuvering room to ease further. Excluding food and energy, however, the latest year-over-year increase in consumer prices is 4.1%. At this time in 1984, the comparable increase was 5.1%. The underlying inflation rate has abated, but only by a percentage point.

The substantial dollar depreciation thus far is bound to produce visible upward pressures on inflation. These pressures will be partially offset by continuing high levels of imports from low-wage countries, such as South Korea and Taiwan, whose currencies to date have hardly moved against the dollar. Now that oil prices have risen from their lows, it seems reasonable to expect the inflation rate to approach 4%-4.5% at some point in 1987. Worldwide excess capacity for many industrial and agricultural commodities, however, has been an important factor in keeping inflation low during the last few years and will likely continue to do so during the next several years as well.

Bernard Schoenfeld

Irving Trust

Economic Forecast

Percent Changes at Annual Rates

	Actual		1986					Forecast 1987	Actual 1984-1985	Forecast 1985-1986	Forecast 1986-1987
	I	II	III	IV	I	II	III	IV			
Gross National Product	6.2	3.0	6.6	8.4	7.8	8.4	3.3	7.2	6.2	5.7	7.2
Real GNP	3.8	0.6	3.1	4.3	4.0	4.0	3.7	2.5	2.7	2.7	3.6
GNP Price Deflator	2.5	2.5	3.3	3.9	3.7	4.3	4.4	4.6	3.4	2.9	3.5

	Actual 1986:II	Forecast 1986:III	Actual 1984-1985	Forecast 1985-1986	Forecast 1986-1987
Consumer Spending	5.7%	9.5%	7.1%	6.4%	6.7%
Durable Goods	17.6	20.3	8.5	5.8	4.2
Nondurable Goods	-0.3	5.6	4.0	3.8	6.1
Services	6.7	9.3	8.9	8.3	7.7
Business Capital Spending	-2.3	3.4	10.0	0.5	3.1
Structures	-32.3	-6.1	11.1	-7.7	-2.3
Equipment	16.0	7.9	9.4	4.7	5.6
Residential Investment	21.9	16.5	5.7	13.8	9.0
			1985	1986	1987
Change in Inventories	$12.5b.	$-4.5b.	$11.1b.	$17.0b.	$27.5b.
Net Exports of Goods and Services	$-100.2b.	$-109.2b.	$-78.9b.	$-102.1b.	$-91.5b.
			1984-1985	1985-1986	1986-1987
Government Purchases	11.6%	8.9%	11.2%	6.3%	7.5%
Federal	13.4	12.9	13.7	4.9	9.1
Defense	18.6	13.8	10.4	8.3	9.5
Other	-0.9	10.2	24.3	-4.4	7.7
State & Local	10.4	6.1	9.3	7.4	6.3
Corporate Profits Before Tax	8.5*	4.1*	-5.3	4.1	8.5
Corporate Profits After Tax	11.1*	8.7*	-6.4	7.1	4.0
Plant and Equipment Expenditures	-0.5	1.2	9.2	-1.9	1.0
Real Final Sales#	3.8	4.9	4.2	2.6	3.3
Real Disposable Personal Income	7.4	3.3	2.3	4.1	3.7

Economic Indicators	Recent Data June	July	Aug.	Actual 1984-1985	Forecast 1985-1986	Forecast 1986-1987
Consumer Price Index**	6.0%	0.0%	n.a.	3.7%	2.0%	4.0%
Producer Price Index for Finished Goods**	0.0	-4.8	3.6%	2.1	-1.4	3.7
Industrial Production	-0.3	-0.1	n.a.	2.2	0.3	2.0
Retail Sales##	0.2	0.3	0.8	6.5	4.4	5.0
				1985	1986	1987
Auto Sales (millions of units, a.r.)	11.1	10.7	12.7	11.1	11.2	10.4
Housing Starts (millions of units, a.r.)	1.85	1.82	n.a.	1.74	1.88	1.70
Unemployment Rate	7.1%	6.9%	6.8%	7.2%	6.9%	6.5%
Merchandise Trade Deficit (a.r.)	$170.0b.	$216.4b.	n.a.	$148.5b.	$170.0b.	$145.0b.

Unless noted otherwise, all data are period-to-period percent changes at annual rates, derived from seasonally adjusted data.

September 12, 1986

#GNP less change in inventories, both in real terms.
##Monthly percent changes are not annualized.
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$b. = billions a.r. = annual rate F = Forecast

Economic Outlook

Irving Trust

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Economic Research &
Planning Division

B 4750-2

October 1986

For more than two years now, the performance of the economy has been characterized by modest growth in real gross national product and a sideways movement in industrial production, accompanied by intense problems in particular industries. At times the economy would provide hints of a speedup in growth, only to revert to a sluggish mode in following months. Even now, it is possible to find signs of weakness in the economy as well as positive developments. Our assessment is that the economy will continue to expand for several more years, with somewhat faster growth in 1987 than in 1986.

In late August and early September, several surprisingly positive reports on the economy were released. New orders for durable goods rose 4.3% in July, the sharpest gain in nearly two years, while manufacturing employment was reported to have risen by 19,000 in August, the first increase this year. In the most recent batch of reports, however, durable goods orders fell 2.6% in August, while the July gain was revised down to 3.4%. In addition, manufacturing employment fell by 38,000 in September, while the August report was revised to show an increase of only 1,000. In an often repeated pattern, the tone of the economy seemed to shift back and forth between negative and positive.

Despite the weakness in certain recent economic reports, some positive developments are nevertheless evident. For example, after a series of steady increases, new orders for computers and other office equipment were 51.0% higher in August than in April. The turnaround in this industry is important; investment in computers contributed a full percentage point to real GNP growth in the second quarter. The recent bottoming-out of the oil rig count, aside from being welcome news for the Southwest, also indicates that drilling activity will not be the substantial drag on GNP growth that it was earlier this year.

If the economy is to expand at a faster pace than the 2.5% annualized growth rate of the past two years, the merchandise trade balance will at a minimum have to stabilize and eventually have to narrow, first in real terms and then in current dollar terms. Despite the apparent lack of progress in shrinking the trade deficit so far, some signs are evident that dollar depreciation is indeed working the way it is supposed to in particular industries. For example, imports of paper and paperboard (on a tonnage basis) rose 23.3% from 1983 to 1984 as the dollar appreciated. During the first seven months of this year, imports fell 0.9% from the comparable period a year ago. At the same time, exports rose 16.4% during the first seven months of this year, after declining in both 1984 and 1985. The pattern is similar for wood pulp as well: Imports are now falling slightly, while exports rose 14.9% during the first seven months of this year. In addition, real exports of capital goods rose 10.7% at an annual rate in the first half of this year compared to the level in the second half of last year. Although the pickup in U.S. exports still has a long way to go if our trade deficit is to be brought under control, the benefits of the lower dollar are already visible in some industries.

Bernard Schoenfeld

Irving Trust

Economic Forecast

Percent Changes at Annual Rates

	Actual		1986					Forecast 1987	Actual 1984-1985	Forecast 1985-1986	Forecast 1986-1987
	I	II	III	IV	I	II	III	IV			
Gross National Product	6.2	2.6	6.9	8.0	7.6	8.6	8.2	7.2	6.2	5.7	7.1
Real GNP	3.8	0.6	3.0	4.2	3.8	4.2	3.7	2.6	2.7	2.7	3.6
GNP Price Deflator	2.5	2.5	3.2	3.6	3.6	4.2	4.4	4.5	3.4	2.9	3.4

	Actual 1986: II	Forecast 1987:III	Actual 1984-1985	Forecast 1985-1986	Forecast 1986-1987
Consumer Spending	5.2%	12.0%	7.1%	6.5%	6.7%
Durable Goods	15.3	50.1	8.5	8.2	5.9
Nondurable Goods	-0.6	5.3	4.0	3.6	5.9
Services	6.5	7.6	8.9	8.0	7.4
Business Capital Spending	--1.5	3.7	10.0	0.7	2.8
Structures	-29.8	-5.8	11.1	-7.0	-1.9
Equipment	15.8	8.2	9.4	4.7	4.9
Residential Investment	21.0	13.7	5.7	13.5	8.6
			1985	1986	1987
Change in Inventories	$14.5b.	$-13.5b.	$11.1b.	$14.1b.	$25.2b.
Net Exports of Goods and Services	$-104.5b.	$-114.1b.	$-78.9b.	$-105.6b.	$-96.9b.
			1984-1985	1985-1986	1986-1987
Government Purchases	12.0	8.7	11.2	6.3%	7.4%
Federal	14.1	12.3	13.7	4.9	8.9
Defense	19.3	12.9	10.4	8.2	9.2
Other	-0.4	10.2	24.3	-4.3	7.8
State & Local	10.7	6.0	9.3	7.5	6.3
Corporate Profits Before Tax	8.2*	1.4*	-5.3	3.4	6.9
Corporate Profits After Tax	8.9*	4.0*	-6.4	3.9	1.2
Plant and Equipment Expenditures	-0.5	1.2	9.2	-1.9	1.0
Real Final Sales#	3.4	6.4	4.2	2.6	3.2
Real Disposable Personal Income	7.1	-0.6	2.3	3.5	3.2

Economic Indicators	Recent Data July	Aug.	Sept.	Actual 1984-1985	Forecast 1985-1986	Forecast 1986-1987
Consumer Price Index**	0.0%	2.4%	n.a.	3.7%	2.2%	4.0%
Producer Price Index for Finished Goods**	-4.8	3.6	4.8%	2.1	-2.2	3.8
Industrial Production	0.3	0.1	n.a.	2.2	0.9	2.2
Retail Sales##	0.3	0.8	n.a.	6.5	4.4	6.4
				1985	1986	1987
Auto Sales (millions of units, a.r.)	10.7	12.7	16.1	11.1	11.4	10.5
Housing Starts (millions of units, a.r.)	1.82	1.82	n.a.	1.74	1.88	1.70
Unemployment Rate	6.9%	6.8%	7.0%	7.2%	7.0%	6.5%
Merchandise Trade Deficit (a.r.)	$216.4b.	$159.8b.	n.a.	$148.5b.	$170.0b.	$145.0b.

Unless noted otherwise, all data are period-to-period percent changes at annual rates, derived from seasonally adjusted data.

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#GNP less change in inventories, both in real terms.
##Monthly percent changes are not annualized.
*Year-over-year percent changes.
**Annual percent changes are December to December (not seasonally adjusted).

$b. = billions a.r. = annual rate F = Forecast